

Strong Economy Energizes Commitment to Target Funding to Underserved

Federal agencies administering programs to assist small business continue to devise policies that better monitor program performance while increasing efficiencies to allow budget appropriations to accomplish more. As a part of the change in management style, agencies are requiring private sector participants to take on more risk and management responsibilities in exchange for Federal guarantees. Through this process, agencies are finding ways to cooperate with the private sector to better meet the social goals of these programs.

The importance of small business to the general economy is used to support the current Administration's budget increases for nearly all business assistance programs. According to data from the Commerce Department's Survey of Current Business that has been compiled by the Office of Advocacy, a division of the Small Business Administration, small businesses were central to the gross domestic product's strong 4.4-percent growth in 1996 and nonfarm employment rise of 2.5 percent. Nationwide, new firms rose by 2.8 percent over 1995, while business terminations decreased by 1.6 percent. Small-firm-dominated industries added 1.5 million net new jobs.

Other studies have shown that 3.5 million businesses are owned by minorities in the United States. However, if the percentage of minority businesses were equal to the percentage of minorities in the overall population, there would be 6.8 million such businesses. The apparent discrepancies in how minorities have participated in the current economic expansion has focused recent efforts to sharply increase Federal assistance to small and minority-owned businesses and to make more Federal capital available to minority entrepreneurs. In addition to increasing funding, agencies are establishing more rigorous methods of evaluating whether the targeted groups are being served. Secretary of Agriculture Dan Glickman established the National Office of Outreach to assure that small and minority businesses have full access to all USDA programs and services.

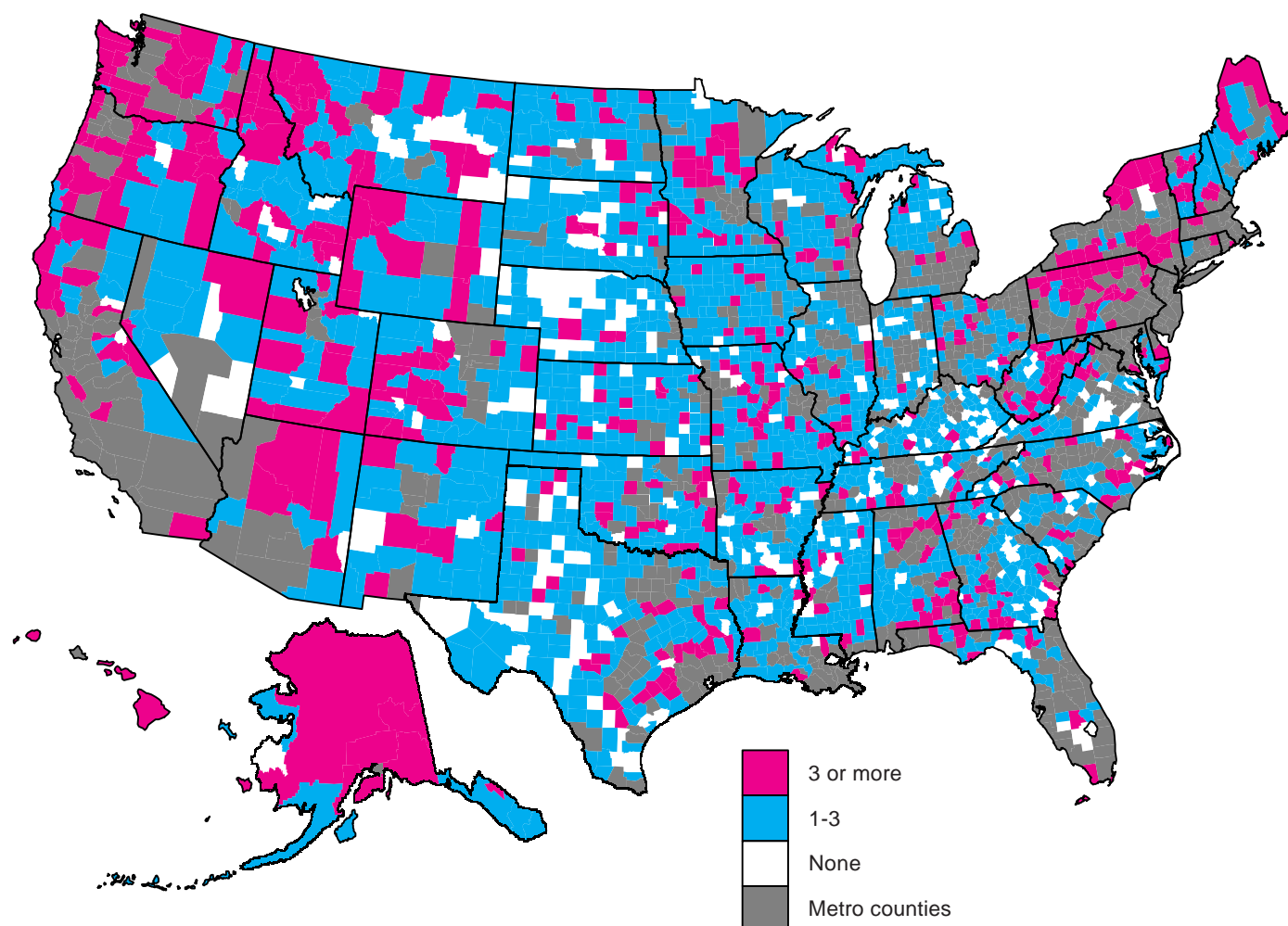
Of the 2,276 counties designated as nonmetro (or rural) in 1996, 320 received no business program assistance at all (fig. 1). By contrast, more than 400 counties received assistance from three or more programs. Those counties not receiving assistance were concentrated in the Great Plains and in various parts of the South. The location of these counties suggests that areas with little or no population growth or that are seriously underdeveloped may be less likely to generate demand for credit and, thus, may make less, or no, use of credit-market-enhancing programs. This assistance pattern may also reflect a possible need to better inform the public of what Federal small-business assistance is available.

Expansion in Program Activity Expected to Continue

Over the last 5 years, the level of funding for business assistance programs has steadily increased and the types of assistance offered have broadened. Over 20 programs are available to make capital more accessible at reduced interest rates; and many of these programs provide technical assistance to increase the small business borrower's probabilities of success. The largest programs are guaranteed loan programs that increasingly rely on private sector lenders to screen applicants and monitor loan performance. Beginning in the early 1990's and even more so in the last two budget cycles, agencies assisting small business development have energetically developed new programs to better target microbusinesses and those businesses not well suited to traditional borrower-lender relationships.

The Small Business Administration (SBA). SBA offers over 15 different programs to meet the varying financial needs of small business. SBA's largest business assistance program, the section 7(a) guaranteed loan program, is projected to increase its program level from \$9 billion in 1997 to \$9.2 billion in 1998 (all references to years refer to fiscal years). This program is available to both metro and nonmetro areas, but is of particular importance to nonmetro areas, many of which rely almost exclusively on small businesses for their employment growth. The number and volume of loans made under the 7(a) guarantee program have increased dramatically in recent years. In 1992, SBA made or guaranteed approximately 24,000 loans totaling about \$5.9 billion. By 1997, that increased to approximately 45,000 loans totaling about \$9.5 billion. As the number of loans and volume outstanding have increased, the average percentage of the loan that

Figure 1

Number of small business programs benefiting rural counties, fiscal year 1996*Many of the 320 nonmetro counties without small business assistance are in the Great Plains*

Source: Calculated by ERS using Federal Funds data from the Bureau of the Census.

was guaranteed has declined: 81 percent was guaranteed before 1992, while 73 percent was guaranteed in 1997. In 1996, nonmetro areas received \$24 in per capita small business 7(a) guarantee assistance, somewhat less than the \$27 received in metro areas; the nonmetro areas that benefited most were in counties in the West that were not adjacent to metro areas, and in counties specializing in services and farming.

The second largest SBA program, the section 504 Certified Development Loan Company program, is projected to increase its obligations from \$1.4 billion to \$2 billion in 1998. The section 504 program has also significantly grown. In 1992, the 504 program assisted about 290 Certified Development Companies (CDC's), making about 2,000 long-term loans totaling nearly \$560 million. In 1997, about 6,900 loans were made through the same network of 290 or so CDC's totaling \$1.4 billion. In 1996, nonmetro counties on average received just over \$8 per capita in 504 loan guarantees compared with over \$11 per capita for metro ones. Among nonmetro areas, nonadjacent nonmetro counties received more funding per capita than those adjacent to metro counties, and western counties and counties emphasizing service industries benefited the most (table 1).

USDA's Rural Business-Cooperative Service (RBS). RBS's main business assistance programs are the Business and Industry (B&I) program, the Intermediary Relending

Table 1

Selected business assistance programs

Most business loan guarantee programs are expected to increase or maintain steady loan activity in 1998

Program	Program level by fiscal year ¹			Rural areas most affected by the program
	1997 actual	1998 estimate	Change	
	—Billion dollars—		Percent	
SBA 7(a) business loan guarantees	9.00	9.20	2	Services, farming, and Federal lands counties in West
SBA Certified Development Loan Company guarantee (section 504)	1.42	2.00	41	Services counties in West
SBA disaster loans	.96	.79	-18	Place experiencing disasters
RBS Business and Industry loan guarantees (B&I)	.82	1.00	22	Service and mining counties in West
RBS Intermediary Relending Program	.04	.04	0	Farming, Government, nonadjacent, and Federal lands counties in West
RBS Rural Business Enterprise Grants (RBEG)	.05	.04	-20	Farming, service, and transfer counties in West and South
EDA Economic Adjustment ² Grants	.03	.03	0	Farming and totally rural counties in West

Note: EDA = Economic Development Administration, U.S. Department of Commerce. RBS = Rural Business-Cooperative Service, U.S. Department of Agriculture. SBA = Small Business Administration.

¹ Budget authority used for grant programs; projected loan levels (obligations or program level) used for loan programs. Note that in some cases, budget authority may be falling at the same time that projected loan obligations are rising. This can happen for any number of reasons, including making use of greater efficiencies, reducing subsidies, charging fees, and using unobligated balances of funds from prior years.

² This represents just part of the larger EDAP program (see text); many of these grants are used to support revolving loan funds that issue loans to businesses; hence, a larger number of loans will result than indicated by this budget authority amount.

Source: *Budget of the United States Government, Fiscal Year 1998.*

Program (IRP), and the Rural Business Enterprise Grants (RBEG) program. Of the three agencies involved in providing direct financial assistance to small businesses, RBS is the only one to have program restrictions regarding size of community. RBS's programs are generally available to communities with less than 50,000 in population; in the case of the IRP, city populations are limited to 25,000.

The B&I program includes both guaranteed loans and direct loans. The larger guaranteed program created about \$820 million in loan activity, through its guarantees, in 1997. The program is projected to create upwards of \$1 billion in loan activity in 1998, for an

increase of 22 percent. The IRP is expected to remain steady and provide around \$40 million in low interest-rate loans to capitalize revolving loan funds in rural areas. The RBEG program provided about \$50 million in grants in 1997, but, due to budgetary constraints, is projected to decline in activity by about 20 percent for 1998.

Commerce Department's Economic Development Administration (EDA). EDA operates another program benefiting rural businesses, the Economic Adjustment Program (EAP). As the name implies, the EAP helps local areas make adjustments to severe changes in their economic situations. Funding for the EAP remains steady at about \$31 million in 1998. Approximately 10 percent of this amount will be available to make grants to capitalize revolving loan funds. Through the revolving loan funds, EAP provides most of its assistance to small businesses.

Reinvention Efforts Continue to Improve Business Assistance Programs

Rapidly evolving financial markets are changing both the structure of intermediaries as well as the types of clients they are serving. Competition within and across business lines, along with changing regulatory structures and increasingly sophisticated analytical techniques, have lenders seeking out some borrowers previously thought to be uncredit-worthy. In addition, funds are flowing more readily to their most productive uses, and information quality and quantity has increased as well. Together, these changes are affecting the roles, risks, and operations of Federal credit programs. If the main Federal role is to provide credit that private markets would not otherwise provide, then Federal credit programs must evolve as private credit markets evolve, and the success of these programs must be measured meaningfully. Implementation of the Government Performance and Results Act (GPRA) will help to assess whether programs are achieving their intended results in practice—and will improve the odds for success. The Federal Credit Reform Act of 1990 began to reconcile the tension between achieving social goals or purposes and “business-like” financial management. Implementation of GPRA is bringing the realization that a program's social success and financial success are two facets of the same goal.

SBA, RBS, and EDA have each become more efficient as a result of efforts to implement the requirements of GPRA. Portfolio performance has improved for the SBA's 7(a) guarantee program, and RBS's B&I loan portfolio loss rates have declined. Additional improvements have come as better loan information is gathered and other technical refinements have been made allowing subsidy rates on Federal credit assistance to be lowered. This results directly in lower cost to the agency per dollar of loan activity.

The Future of Small Business Credit Assistance

As more has been learned about how Federal credit programs can complement private markets, program outcomes have become more successful. Previous successes are resulting in an across-the-board refocusing of primary program missions. In keeping with the goal of making credit available where it otherwise would not be, each agency that administers a small business assistance program in 1998 is pushing program accessibility to the poorest and other neglected members of the economy.

The SBA Microloan Program is targeted to very small businesses with financing needs of \$25,000 or less. This program was made permanent in December 1997 under P.L. 105-135. To date, over \$65 million has been lent to almost 6,600 microborrowers. In addition to very small loans, the program offers business-based technical assistance to each microloan client.

In addition to the SBA Microloan Program, SBA will be focusing its programs, performance, and policy objectives on increasing small business opportunities by (1) concentrating on traditionally underserved small businesses; (2) offering specialized financing products, such as venture capital, export financing, and bonding opportunities; (3) improving methods of providing credit assistance through electronic lending, less documentation, centralized functions, and one-stop capital access points; (4) reducing costs

by maintaining a high-quality portfolio through an improved liquidation process; and (5) effectively implementing a loan asset sales program. Number four is an example of placing more responsibility for financial performance of a loan on the private sector lender. For the lenders to exercise the loan guarantee, they are now required to liquidate all relevant chattel, which secures the loan. This reduces the guarantee costs for the SBA.

USDA's RBS has implemented similar types of goals and is also requiring more financial responsibility of participating lenders. USDA will also be focusing on meeting the financing needs of persistent-poverty, declining-population, and minority rural areas. One example is the newly revised IRP program, which will be more directly targeted to the poorest rural areas. Also, loan applications will now be approved at the State office rather than the national office. *[George Wallace, 202-694-5369, gwallace@econ.ag.gov]*